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¶1. (U) Summary. This is Volume 8, issue 26 of U.S. Embassy Pretoria's South Africa Economic News Weekly Newsletter.

Topics of this week's newsletter are:
- Inflation Rises to 10.9%
- SARB Governor Hints at a Further Rate Hike
- Current Account Gap Widens
- SA's Credit Ratings in Spotlight
- Retail Confidence Levels Improve
- Dubai Hopes to Attract More SA Investors
- France to Use SA as a Platform to Increase Trade in Anglophone Africa
- SAG Silence Puts Eskom Ratings in Jeopardy
- SAG to Promote Nuclear Power Generation
- SA Companies to Increase Submission of Greenhouse Gas Emissions Data
- Tata Set to Increase Share in Neotel
- Dubai-based Telecom Group Hopes to Negotiate New Offer for Telkom
- Australia and SA Discontinue Collaboration in Radio Astronomy
- Weak Rand Makes SA Ideal Spot for Tourists

- Tourism to Reap Benefit of Open Skies
End Summary.

Inflation Rises to 10.9%

¶2. (U) Statistics SA (StatsSA) reported that CPIX inflation reached a 51/2-year peak when it increased from 10.4% y/y in April to 10.9% y/y in May. The rise was driven once again by the soaring costs of food and fuel. Food prices delivered the worst shock, about 17% higher than in May 2007 and accounted for nearly half the overall increase in CPIX. That is bad news for low-income earners, who spend half their income on food. Food inflation for the lowest-income earners jumped 18.5% y/y, well above a 16.3% y/y rise for the top-income group. Transport prices were the next big offender, rising 16.7% y/y after a 6.2% fuel price rise in May. Fuel prices increased by another 5.2% in June and further hikes are in store for July as global oil prices continue to scale new peaks. The rand firmed 1.3% to R7.88 against the dollar after the CPIX data was released, which traders said sealed the case for another interest rate hike in August. Higher interest rates boost the

rand's "carry trade" yield appeal. Analysts said CPIX inflation will climb beyond the 12% peak predicted by the Reserve Bank earlier this month, which makes the return of CPIX to within the target band in 2010 unlikely and further monetary policy adjustment definite. Most analysts expect another 50-basis-points interest rate hike in August. Most emerging market countries that target inflation have failed to meet their goals this year. A rising number, including Brazil, India, and Turkey, have raised rates. (Business Day, June 26, 2008)

SARB Governor Hints at a Further Rate Hike

¶3. (U) SARB Governor Tito Mboweni remained hawkish on the interest rate outlook. Mboweni noted that rising food and fuel costs were contributing to inflationary pressures. He also stated that inflation is more broad-based, as rising interest rates and taxes and increases in the cost of education and health care costs are also adding to the problem. He reiterated the SARB's concerns over rising inflation expectations, stating that "Inflation expectations have gone up and these feed into the demand for higher wages". Mboweni criticised the 27.5% electricity tariff increase awarded to QMboweni criticised the 27.5% electricity tariff increase awarded to Eskom this year and stressed that the SARB remains committed to the inflation-targeting framework despite criticism from various sectors of society. Mboweni said that the tighter monetary policy environment seems to be having the desired effect, but warned that more rate hikes could be on the cards and that "it would be painful". Mboweni's speech builds on the SARB's hawkish rhetoric of the past few months, and the overall message suggests that interest rates are likely to rise further. This is in line with the views of most economists who predict a further 50-basis-point interest rate hike at the August 13-14 Monetary Policy Committee meeting. (Beeld, June 23, 2008)

Current Account Gap Widens

¶4. (U) The SA Reserve Bank (SARB) announced that the deficit on the current account widened to a record R194.6 billion ($25 billion) or 9% of gross domestic product (GDP) in the first quarter of 2008. The current account was negatively affected by soaring oil imports and increased dividend payments on local assets held by foreigners. Foreign investment in stocks and bonds, which have provided most of the finance for the deficit in the past few years, swung into negative territory for the first time since 2005, with an outflow of R19.4 billion ($2.5 billion). Analysts warned that if international investors have any doubts about SA being able to finance the current account deficit, it could put pressure on the currency and interest rates. The rand has weakened by nearly 17% against a trade-weighted basket of currencies so far this year in a trend that stokes inflation by making imports more expensive. Further depreciation could prompt more hikes in interest rates, which have already climbed five percentage points in the past two years, curbing economic growth. The SARB's June quarterly bulletin noted that a surge in foreign direct investment to R40.6 billion ($5.2 billion), mainly due to the purchase of a 20% stake in Standard Bank by a Chinese bank, helped cover the shortfall in the first quarter of
¶2008. The current account deficit was also funded by a large increase in foreign deposits with SA banks, which may stem from the yield appeal of SA's higher interest rates. But this sort of inflow is known as "hot money" due to its volatile and short-term nature. Analysts predict that the current account deficit for the whole of 2008 could amount to 9% of GDP, up from 7.3% in 2007 and its highest level since 1951, when it reached to 10.1%. (Business Day, June 20, 2008)

SA's Credit Ratings in Spotlight

¶5. (U) Reuters reported that Moody's positive credit rating for SA

may also be under pressure following news that Fitch downgraded the outlook on SA's sovereign rating from Positive to Stable. Moody's reportedly said that SA's credit rating is dependent on the SAG maintaining current economic policies and curbing xenophobic violence. A substantial widening of the current account deficit, inflationary pressures, and slower economic growth are all adding to a gloomier outlook. Moody's report highlights the attention SA will receive after the 2009 general elections, with speculation that the new administration might review inflation targeting and adopt a more expansionary fiscal policy. However, African National Congress (ANC) President Jacob Zuma announced that there would be no major policy shifts when the new administration takes over next year. Zuma said that the ANC's economic policies are already in existence as they were adopted at the 52nd national ANC Conference in Polokwane in December 2007. (Beeld, June 20, 2008)

Retail Confidence Levels Improve

¶6. (U) The Bureau for Economic Research's (BER) retail confidence
Q6. (U) The Bureau for Economic Research's (BER) retail confidence
index recovered to 56 index points in the second quarter of 2008 after falling to a five-year low of 52 index points in the first quarter. The majority of respondents remain satisfied with prevailing business conditions. The improvement in the second quarter sentiment, which is not reflected in retail activity, may be related to an improvement in the electricity supply situation during the quarter, compared with the situation in the first quarter. However, respondents also indicated that they expect business conditions to deteriorate in third quarter of 2008. (ABSA Newsletter, June 23, 2008)

Dubai Hopes to Attract More SA Investors

¶7. (U) Dubai Airport Free Zone (DAFZ) Marketing Director Ibrahim Ahli announced that Dubai was seeking additional SA investment at an event organized to educate SA entrepreneurs about investment opportunities in the booming city. SA investment in Dubai has risen by 130% since 1999. Ahli noted that petrochemicals giant Sasol had

already established an office in Dubai. Department of Tourism and Commerce Southern Africa Marketing Director Antoinette Lintvelt Lloyd listed other SA companies that have established a presence in Dubai. The list includes SA restaurant chain Nandos, construction firm Murray & Roberts, defense company Denel, and retailer Woolworths. The main business opportunities for SA companies were in the healthcare, media and technology, and education and training sectors, amongst others, Lintvelt Lloyd said. Tourism, trade, transport, construction and financing also offered opportunities, she said. Llyod noted that almost 100,000 South Africans visited Dubai in 2007, up from about 4,000 in 2006. Johannesburg Chamber of Commerce and Industry representative Keith Brebnor said that SA had some catching up to do to take advantage of business opportunities in Dubai. (Engineering News, June 24, 2008)

France to Use SA as a Platform to Increase
Trade in Anglophone Africa

¶8. (U) Embassy of France Economic and Commercial Counselor Yves de Ricaud said France is looking to increase its presence in English-speaking countries and will use SA as a platform to do this. De Ricaud was speaking at a French Chamber of Commerce and Industry breakfast meeting in Johannesburg. He indicated that in Southern Africa, France was mainly exporting to French-speaking countries. "French exports in countries such as the Seychelles and Madagascar have a market share of about 10%, which is much more than the world average market share of about 5%," he noted. Frances export market share in SA was about 4%. "One way to increase France's market share in other regions besides SA is to use the country as a platform," De Ricaud said. He emphasized that France played an important part in the SA economy, employing some 30,000 people in

170 subsidiaries. (Engineering News, June 25, 2008)

SAG Silence Puts Eskom Ratings in Jeopardy

¶9. (U) The three major international rating agencies - Moody's, Standard & Poor's, and Fitch - are now looking to the SAG for signals on its contribution to Eskom's capacity expansion program before they will upgrade Eskom's ratings outlook. According to the local press, the lack of clarity on the nature and extent of the SAG's financial support has rendered the National Energy Regulator of SA (NERSA) decision to allow an additional 13.3% average increase in electricity tariffs inadequate to warrant a change in Eskom's ratings outlook. The three rating agencies were unanimous that, without an indication of SAG support, their ratings of Eskom would remain unchanged. Moody's placed Eskom on review for a possible downgrade earlier this year, while Standard & Poor's and Fitch had the company on negative watch. Four months after Minister of Finance Trevor Manuel announced a R60 billion ($7.7 billion) loan to Eskom, the SAG has failed to announce a loan disbursement strategy. The Department of Public Enterprises and the Department of Minerals and Energy issued a joint statement shortly after the NERSA decision
Qand Energy issued a joint statement shortly after the NERSA decision
indicating that there is a SAG team working on determining the "appropriate" financial injection to strengthen Eskom's balance sheet. Faced with a $44 billion expansion program, Eskom cannot afford a slip in its credit ratings as the bulk of the financing will come from local and international creditors. Fitch plans to meet Eskom management "to discuss their business plan in light of the most recent regulatory developments." (The Weekender, June 21-22, 2008)

SAG to Promote Nuclear Power Generation

¶10. (U) The SAG approved a nuclear energy policy last week that promotes atomic energy as a primary source for power generation. A cabinet statement indicated that the "policy will also ensure the reduction of our over reliance on coal, which contributes to SA being among the world's highest emitters of greenhouse gases". The Department of Minerals and Energy has been tasked to flesh out the practical details of the policy and oversee its implementation. The adoption of the policy will require the recapitalization of the national nuclear regulator and the Nuclear Energy Corporation of SA (NECSA). NECSA's research and development budget will need to be

bolstered. Three new agencies are proposed under the policy: the National Nuclear Security Agency (to integrate the existing nuclear safety responsibilities into a single agency); the National Nuclear Architectural Capability (to oversee the development of a national supplier network of nuclear equipment and nuclear reactors); and the National Radioactive Waste Management Agency (to manage radioactive waste). NECSA has been designated the lead agency in the implementation of this policy, while Eskom is the only power company allowed to build nuclear energy stations. According to the timelines provided in the policy, SAG hopes to encourage the establishment of local manufacturing capacity for nuclear equipment and components by 2015. (Financial Mail, June 20, 2008)

SA Companies to Increase Submission
of Greenhouse Gas Emissions Data

¶11. (U) Over fifty of SA's companies are expected to disclose information about their carbon emissions, which will be incorporated into the world's largest databank of greenhouse gases (GHG) later this year. The exercise dubbed the Carbon Disclosure Project (CDP) was launched in 2007, with an initial target of 40 SA companies. The CDP project entails GHG emissions accounting, management, reduction and cost accounting. Although 40 companies were targeted in 2007, only 15 provided quantitative data on emissions. The local CDP operators Incite Sustainability and the National Business

Institute observed that many companies have started to acknowledge that the carbon footprint issue affects business. SA firms in the agriculture sector and wine production are already feeling the pressure exerted by importers and retailers, who demand to know the size the exporters' carbon footprint. Incite Sustainability's John Hanks said the CDP has received 28 companies' responses thus far. Twenty-one companies requested extensions, while another eight confirmed their intention to respond. Targeted corporations include Sasol, BHP Billiton and Anglo-American. (Business Report, June 17, 2008)

Tata Set to Increase Share in Neotel

¶12. (U) Tata Communications announced that it would acquire a further 30% stake in SA's second fixed-line operator Neotel from State-owned enterprises Eskom and Transnet. If the acquisition were to succeed, Tata Communications would hold an effective 56% stake in Neotel. Nexus, Communitel, and the Two Telecom Consortium are the other stakeholders in Neotel. Tata Communications is part of the $29 billion Tata Group of India. (Business Day, June 25, 2008 and Engineering News, June 24, 2008)

Dubai-based Telecom Group Hopes to
Negotiate New Offer for Telkom

¶13. (U) Dubai-based Oger Telecom announced intentions to negotiate a new offer for SA's largest telecom operator Telkom, with the company's potential local buyers. A consortium led by Mvelaphanda Holdings reported that it was considering making an offer for Telkom, if Telkom sold its 50% stake in mobile unit Vodacom. Oger QTelkom, if Telkom sold its 50% stake in mobile unit Vodacom. Oger Telecom, which owns SA's mobile operator Cell C, wants to merge Cell C with Telkom's fixed-line business. "We want to create a model in SA that is similar to what we have in Turkey between Turk Telekom and Avea," Oger Telecom CEO Paul Doany told Reuters. Oger has a controlling 55% stake in Turk Telekom and 81% in Avea, Turkey's third-largest mobile operator. "We believe fixed/mobile convergence to be ideally suited to the market in SA and that there is much to be gained by all stakeholders in that regard," said Doany. (Engineering News, June 24, 2008)

Australia and SA Discontinue
Collaboration in Radio Astronomy

¶14. (U) Australia and SA recently agreed to discontinue collaboration in the development of a radio astronomy software

program known as the Convergent Radio Astronomy Demonstrator (Conrad). Australia and SA jointly established Conrad in 2006 to develop software for the SA Karoo Array Telescope (MeerKat) and the Australian Square Kilometer Array Pathfinder (ASKA). The software technology requirements for the two projects had begun to diverge, seeking different software development approaches and data processing. The parties also received larger than expected funding, which will allow them to pursue software development independently. The two parties will continue to share relevant information despite the split. Both countries are also the front-runners in the bid to host the mult-billion-dollar Square Kilometer Array (SKA) radio telescope, which will be 50 times more sensitive than current telescopes. ASKA and Meerkat are the precursors to the SKA project. The Conrad Telescope Operating System was developed by the two countries. It is currently operating SA's MeerKat prototype dish at the Haartebeesthoek Radio Astronomy Observatory, west of Pretoria. (Engineering News, June 20-26, 2008)

Weak Rand Makes SA Ideal Spot for Tourists

¶15. (U) The Tourism Investment Corporation expected the sector to do well as a result of the weaker rand, which made SA more attractive to incoming tourists. CEO Tommy Edmond forecasted that visitors would still come from overseas despite economic difficulties in the U.S. and Europe, and the higher cost of long-haul flights. Edmond said most tourists planned holidays in SA far in advance "and they expect the cost of a long-haul flight to be high". "The strength of the Euro against the rand will help to offset this for people from continental Europe, who will find it far cheaper to be here," noted Edmond. "Most of our outbound retail travel business is corporate and this is still holding up well, although leisure travel that has not already been booked will be affected," he added. (Business Report, June 20, 2008)

Tourism to Reap Benefit of Open Skies

¶16. (U) SA Tourism CEO Moeketsi Mosola said SA's decision to open its skies to increased competition from foreign airlines in the run-up to 2010 is finally beginning to pay dividends. The recently concluded UK-SA agreement on air transport, which will add 28 new flights a week between the two countries over the next three years, was evidence of this. SA Tourism and other sector leaders have long called for more flights to SA to meet burgeoning demand but the SAG has been slow to respond. "I have been involved in these discussions for the past seven years as CEO of SA Tourism and it is the first time that I am completely satisfied with the agreement. There is no longer this eye-for-an-eye approach to talks and this agreement offers the airlines much more flexibility in how the frequencies (flights) are used," Mosola said. Under the agreement, airlines in both the UK and SA have been given 14 additional flights between the two countries this year, seven in 2009, and a further seven between London and Durban in 2010. British Airways was first Qseven between London and Durban in 2010. British Airways was first to take up the flight, adding a third daily flight between London's Heathrow and Johannesburg from April 2009. Virgin and South African Airways are still weighing their options. Among the changes provided in this agreement is a clause allowing UK airlines to take up SA flights if SA airlines do not take up their frequencies within a specified time. "That has never been the case in the past," said Mosola. The airlines will now have more choice about which aircraft they use, which airports they use and when they will fly. The press reported that SAG has become more sophisticated and clever in its negotiations. It is not strictly adhering to the principle of reciprocity but looking at what is needed for the country, particularly the tourism sector, to grow. The SAG first outlined a more liberalized approach to bilateral negotiations in a 2006 cabinet-approved airlift strategy document. The document presents a five-year plan for the regulation of air transport in support of the tourism sector with the express aim of ensuring that airline capacity is created ahead of demand. The Department of Transport (DOT) said discussions regarding added capacity were taking place with other governments. DOT has negotiated with Qatar, the United Arab Emirates (UAE), the UK, South Korea, Gambia, and New Zealand and is currently in negotiations with Australia. Further discussions are planned with the Netherlands in the next two months. SA is also in discussion with India on further liberalizing the

existing bilateral agreement, DOT officials said. Talks with the UAE in December 2007 resulted in Emirates adding daily flights between Dubai and Cape Town in March 2008. (Business Day, June 23, 2008)

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